THE NEGOTIABLE INSTRUMENTS LAW. A WORD MORE.

UNDER ordinary circumstances Judge Brewster's "Defense of the Negotiable Instruments Act" in the Yale Law Journal for January would be allowed to close the very friendly controversy begun by a criticism of that Act in the December number of this REVIEW. But it is so much wiser and simpler to avoid the commission of legislative errors than to correct them subsequently that the writer deems it his duty to add to his former paper this short supplement by way of meeting some of the arguments of the learned Chairman of the Committee on Uniform Laws, and of reinforcing some of his own criticisms.[1]

As to the objections to sections 20, 36–2 and 3, 49, 66, 68, 137, and 175 it seems unnecessary to say anything more than that his criticisms still seem to the writer to be valid. In dealing with the other sections criticised, he will follow the order of the Act.

By SECTION 3–2 an order or promise is not rendered conditional by "a statement of the transaction which gives rise to the instrument." These very general words, Judge Brewster tells us, were intended to cover the specific case of a "chattel note," that is, a note stating that it "is given for a chattel which is to be the property of the holder until the note is paid." He tells us further that this sub-section could not apply to a note containing the words, "Given as collateral security for A's debt to the payee," because such an instrument "contains notice on its face that it is not an unconditional promise to pay." But that is the precise ground upon which "chattel notes" are held to be non-negotiable in Massachusetts. In Sloane *v.* McCarthy,[2] Field, J., said: "The obligation of the defendant to pay the money is in legal effect conditional upon the title vesting in him when the money is paid in full, and this condition appears on the face of the contract." The learned

[1] Since the sections criticised and the criticisms must stand or fall upon their intrinsic merits or demerits, any allusion to the critic's qualifications by reason of his previous training or experience would seem to be irrelevant. But since the learned Chairman draws therefrom the inference that "a fulness of expression amounting to prolixity" would be demanded, in order to give effect to the writer's strictures upon the Act, it is right to say that the adoption of his proposed amendments would shorten the Act by something more than a dozen lines.

[2] 134 Mass. 245, 246.

Chairman demonstrates, therefore, by his own reasoning, that this sub-section must fail to work in the very case for which it was framed.[1]

SECTION 9–3. Fictitious payee. In his criticism of this provision the writer tried to make it clear that, as a matter of actual experience, one who makes an instrument payable to a fictitious person always indorses it in the name of that person before issuing it, and that such an instrument is in effect, though not in form, the same as one payable to the order of the drawer or maker. By the Revised Statutes of New York, of 1830, a note payable to the order of the maker was declared to be payable to bearer, and was negotiable by delivery merely, without indorsement. This legislation was copied in at least nine states.[2] But it has been repealed in New York, North Dakota, Oregon, and Wisconsin by section 184 of the Negotiable Instruments Law, which declares that a note payable to the maker's own order "is not complete until indorsed by him." The recommendation of the writer is that a bill or note payable to the order of a fictitious person be dealt with in the same way by enacting that such a bill or note, when indorsed by the drawer or maker in the name of the fictitious person, but only when so indorsed, shall have the effect of paper payable to the order of, and indorsed by, the drawer or maker. Suppose two notes, one payable to the order of a fictitious person and one payable to the order of the maker, but neither of them indorsed, to be lost or stolen and to come to the hands of an innocent purchaser. Where is the logic or the justice in a statute which makes the maker liable in the one case, but not in the other?[3]

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[1] It may be, as the writer believes it to be, an error to regard a "chattel note" as a conditional promise. But courts which commit this error will probably agree with Judge White, the only judge who has passed upon section 3–2, that this provision "has no application" to such a note. On this point Judge White's opinion was not impeached by the reversing opinion in 50 N. Y. Ap. Div. 66.

[2] Rand. Neg. Pap. (2d ed.) sect. 153 n., 401.

[3] If Judge Brewster's startling suggestion that notes payable to the order of unincorporated associations or the estates of deceased persons are payable to bearer by force of this section 9–3, this provision is far more mischievous than the writer had supposed. Is a note payable to the order of a joint stock company unincorporated, or to the order of John Smith & Co., for a partnership is an unincorporated association, payable to bearer? This is incredible. There is a *dictum* in Lewisohn *v.* Kent, 86 Hun, 257, that a note payable to the order of the estate of A is payable to bearer. But surely it is a perversion of language to call the payee in such a note a fictitious or non-existing person. In Shaw *v.* Smith, 150 Mass. 166; Peltier *v.* Babillon, 45 Mich. 384, such a note was properly interpreted as a note payable to the legal representa-

SECTIONS 9–5 and 40. Special indorsement of paper payable to bearer. Prior to the Bills of Exchange Act an instrument payable to bearer (or indorsed in blank), although afterwards indorsed specially, was still negotiable by delivery, as if the special indorsement were not upon it. Hence, even though the bill had been lost by, or stolen from, the special indorsee, any honest purchaser from the finder or thief acquired an indefeasible title to the paper. This was thought to be unjust to the special indorsee, since the buyer had notice on the face of the bill that it had become the property of the special indorsee, and ought, therefore, to make out his right through an indorsement or assignment by the special indorsee. To remedy this injustice was the object of section 8-3 of the English Act, which is reproduced in section 9–5 of the American Law.

The objection to this provision is this: If the special indorsee transfers the instrument by delivery merely, the transferee not being an indorsee, is not a holder[1] and not being a holder cannot, under section 48, strike out indorsements, and so, in order to recover against parties antecedent to the special indorser, must sue in the name of the special indorsee.

Section 40 of the American statute has no counterpart in the English Act, and, by providing that an instrument payable to bearer, although indorsed specially, "may nevertheless be further negotiated by delivery," seems to the writer to nullify the innovating section 9–5, and to leave the law as it was in England before 1882. Judge Brewster seeks to avoid this result by reading section 40 as if it contained, after the word 'negotiated,' the words "by the special indorsee," thus restricting the further negotiation, by delivery to a delivery by him. The suggested explanation is to the writer, far from convincing. He cannot escape the conviction that it is an afterthought. Had the framers of the Act fully realized that section 9–5 was an innovation, and that the language of section 40 was almost identical with that used by judges and text-writers to define the superseded doctrine,[2] one must

tive of A. Mr. Chalmers, who drew the English Act, says that a note payable to a deceased person is payable, since the Act, as it was before it, to his personal representative. Chalmers, Bills of Exch. (5th ed.) 23, 24.

[1] N. I. L. sect. 191.

[2] "Continues to be assignable by mere delivery." Chitty, Bills (11th ed.), 173. "Is transferable by mere delivery." Story, Prom. Notes (7th ed.), § 139. "Is afterwards negotiable by mere delivery." 4 Am. & Eng. Encycl. (2d ed.) 252. "Remains transferable by delivery." 2 Rand. Neg. Pap. § 705. "The negotiability is not restrained." Chalmers, Dig. (1878) 96.

believe that, either they would have followed the English Act, and omitted section 40, or else have abandoned the language of the discarded rule along with the rule itself. Furthermore, to interpolate the additional words is to take an uwarrantable liberty with the statute.

SECTION 22. Indorsement by an infant. The learned Chairman informs us that this section is the same in effect as the corresponding section of the English Act. Other members of his committee assured the writer that the purpose of this section was to give the infant's indorsee an indefeasible title to the instrument. This is not the effect of the English Act. If the framers of this section are not agreed as to its scope, its reference back to the committee for revision would seem to be in order.

In SECTION 29 an accommodation party is defined as one who signs "without receiving value therefor, and for the purpose of lending his name to some other person." This definition was criticised by the writer as excluding the case where the signer receives a commission for lending his name, and the omission of the words "without receiving value for and" was recommended. Judge Brewster shows that the language in this section is the current definition of the books. But this does not meet the criticism. It may indicate only that he and his colleagues erred in good company. To take a concrete case. A offers B $10 if he, B, will sign a note of $1000 for A's accommodation. B accepts the $10 and signs the note. Can any one seriously doubt that B is an accommodation party? If he is, the definition in this section is erroneous.

SECTION 34. The definition of indorsement. A note, a bill, and an acceptance are carefully defined in the Negotiable Instruments Law. To the writer's criticism upon the absence of a definition of an indorsement which would remove the conflict of decisions in cases where the payee writes: "I assign this note to B," or "I guarantee the payment of this note to B," Judge Brewster replies that "the liability of a party on a peculiar indorsement which is outside of negotiability must be settled by a court." But the very point in controversy is one of negotiability, as it was in the case of notes containing a promise to pay attorney's fees. It is unfortunate that an excellent opportunity to unify the law was neglected.[1]

[1] In ten states a payee who transfers a note by writing on the back, "I assign this note to X," assumes the liability of an ordinary indorser. In six states such an assignor is not an indorser. In thirteen states the assignee, like an indorsee, acquires

SECTION 37. Restrictive indorsement. A, the holder of a note payable to his order, sells it to B and is about to indorse it to him, but, at B's request, indorses it to X in trust for B, instead of to B directly. At the maturity of the note the maker is insolvent, but A is solvent. By this section, X, the indorsee, may sue any one that his indorser can sue. In other words, he may sue the insolvent maker, but he cannot sue the solvent indorser, A. Judge Brewster sees no injustice to B in the inability of X, his trustee, to sue A, upon the latter's indorsement. Let us hope that the learned judge may never find himself in B's situation.

SECTION 64. Anomalous indorser. Judge Brewster seems to have misapprehended the writer's criticism upon this section. If A makes a note payable to X or order, gets B to indorse it and delivers it to X in exchange for goods, B is liable, under this section, to X and all subsequent parties. If, however, A accepts a bill drawn by X, payable to the order of X, gets B to indorse it, and delivers it, as before, to X for goods purchased, B, under this section, is not liable to X, but only to subsequent holders. And yet the business relations of A, B, and X are obviously identical in the two cases. In each X sells to A on credit, trusting to the responsibility of both A, the buyer, and B, the surety. The amendment suggested by the writer[1] secures to X the just protection which this section in its present form denies him.

SECTION 65–4 makes the novel distinction that, while a transferor by delivery is liable on his warranty of genuineness only to his immediate transferee, an indorser without recourse, because his name is on the instrument, is liable to all subsequent holders. This distinction was criticised on the ground that the warranty in both cases was extrinsic to the instrument, being merely the warranty of a vendor, and therefore running to the vendee only. The learned Chairman makes merry with the critic by quoting a statement from the Summary of Ames's Cases on Bills and Notes[2] as the first printed expression of the idea that an indorser without recourse is responsible as a warrantor to the indorsee and subsequent holders. The writer frankly confesses that a youthful indiscretion, commit-

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title free from equities good against the assignor. In two states the assignee takes subject to such equities.

In three states a payee who transfers a note by writing on the back, "I guarantee the payment of this note to X," is liable as an indorser. In ten states he is not so liable. In thirteen states the transferee, like an indorsee, acquires a title free from equities good against the transferor. In three states and in the Supreme Court of the United States, the transferee takes subject to such equities.

[1] 14 HARVARD LAW REVIEW, 250. [2] 840, 882.

ted so long ago that it had passed from his memory, made him fair game for the alert sportsman. But, after all, he is not so black as he is painted. In his callow days he never entertained the heresy that the indorser without recourse was liable on the instrument, or that there was any difference between his obligation and that of a transferor by delivery. The liability of each is described in the Summary in the same forms and as extrinsic to the instrument. Nor did he consider that the obligation of either was negotiable. He regarded the warranty as an assignable chose in action, with this peculiarity, that it passed, with the bill or note as an incident, without any express assignment.[1] The writer is indebted to Judge Brewster for recalling to his mind this forgotten conception, for it suggests an additional objection to this sub-section. The distinction introduced between the transferor by delivery and the indorser without recourse must rest upon the fact that the name of the latter is upon the paper, and upon the assumption that such an indorsement is like a regular indorsement, except that the liability is limited to a warranty of genuineness and the like, and, therefore, runs in favor of all subsequent holders.[2] In other words, the indorsement is negotiable, and not merely assignable. A concrete case illustrates the difference. The holder of a bill containing several prior indorsements is induced by fraud to transfer it by an indorsement without recourse. The fraudulent indorsee transfers it to a holder in due course. The signature of one of the prior indorsers turns out to be a forgery. If the warranty of the defrauded indorser is merely an extrinsic, assignable chose in action, the holder in due course, having only the rights of the fraudulent indorsee, cannot charge him; if, on the other hand, as this section of the act must mean, his obligation is a qualified negotiable indorsement, he is chargeable by the holder in due course. This result will hardly commend itself to any one.

SECTION 70. Presentment for payment. To the unqualified statement in this section that "presentment for payment is not necessary to charge the person primarily liable" the writer objected that an exception should be made in the case of bank notes

[1] He agrees now with Dillon, J., that an express assignment is necessary. Watson *v.* Chesire, 18 Iowa, 202.

[2] Similarly, in section 66, the two liabilities of the regular indorser — the warranty of genuineness and the engagement to pay upon due notice of dishonor — are grouped together, and made to run in favor of all subsequent holders, as if both arose upon the instrument itself.

and certificates of deposit. This objection seems to the learned Chairman unpractical. An objection which gives effect to the express intention of the parties and has the support, as to certificates of deposit, of the decisions in at least nine states, would seem to be sufficiently practical.

SECTION 119–4. It is said in defence of this sub-section that it relates only to acts between the parties, and that the holder's acceptance of a horse in satisfaction of a note, if before maturity, does not discharge the maker as against a holder in due course. This is very sound law, but, with all deference, this sub-section declares just the opposite. The language is that by such an accord and satisfaction "a negotiable instrument is discharged." If it is discharged the maker can never be charged upon it. In all the other sub-sections of this section the discharge is complete and final.

SECTION 120. Judge Brewster says that "discharge of a prior party" in sub-section 3 means a discharge "by the holder." To add the words "by the holder" seems to the writer as unjustifiable as the unsuccessful attempt that was made in Vagliano's case[1] to add to the section of the English Act relating to fictitious payees the words, "to the knowledge of the acceptor." Furthermore, if the words were added, to what possible case would this paragraph apply which is not covered by the other paragraphs of this section? Finally, if the words are added, this sub-section would still be indefensible, for it certainly discharges the accommodated indorser of a note, if the holder, with knowledge of the accommodation, should release the accommodating maker. This would be a shocking result and contrary to all the reported decisions on this point. This same illustration demonstrates the inaccuracy of paragraphs 5 and 6 of this section.

SECTION 186 provides that the holder's failure to present a check discharges the drawer only to the extent of loss caused by the delay. To the writer's criticism that, under section 89, the failure to give the usual prompt notice of dishonor of a check discharges the drawer irrespective of any loss to him, and that this is unjust, the learned Chairman replies, that no harm is done, for the holder may sue upon his original claim. But in all other cases a creditor who, by his laches, discharges his debtor from liability on a bill given in conditional payment of a debt, forfeits also all right to the debt. Furthermore, suppose a check to be given in abso-

[1] 1891, App. Cas. 144.

lute payment of the drawer's debt, or in consideration of the payee's release of a claim against a third person. Surely, in either of these cases, the holder, who loses his right on the check, has lost everything.

The writer's criticisms upon the new code may be summed up as follows : —

Section 3–2 is either useless or provocative of litigation. Section 36–2 might well be merged with section 36–3. Section 137 crystallizes an unscientific conception without any compensating advantage.

Section 29 is an erroneous definition. Section 34 is an inadequate definition. Sections 9–5 and 40 are repugnant. Section 68 introduces an unprecedented and arbitrary distinction. Section 70 would settle a conflict of decisions against the majority opinion, which is that of the chief commercial states. Section 175 copies the blunder of the English Act which codified an overruled decision.

Sections 9–3, 20, 37, 49, 64, 65–4, 66, 119–4, 120–3, 120–5, 120–6, and 186, taken with section 89, establish rules opposed alike to justice and to well-established law. Their enactment must inevitably be followed, sooner or later, by additional legislation to remedy the evils they would introduce.

The writer desires to repeat his opinion that the general adoption of the new code, properly amended, would be greatly to the advantage of the mercantile community. But unless the statements in the preceding two paragraphs can be disproved, the passage of the Act in its present form in a single additional state should be an impossibility.

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